

## Internal Revenue Service

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Date:

August 31, 2015

### Legend

Trust =  
Date 1 =  
Date 2 =  
State =  
Plan =  
Statute 1 =  
Statute 2 =

Dear :

This letter responds to a letter from your authorized representative dated March 27, 2015, and subsequent correspondence submitted on behalf of the Trust, requesting a ruling that (1) the Trust's income is excludable from gross income under Internal Revenue Code (IRC) section 115(1) and (2) the Trust is not required to file annual income tax returns under IRC section 6012(a)(4). The Trust represents the facts as follows.

### FACTS

The Trust was established on Date 1, pursuant to the laws of the State. It operates pursuant to a trust agreement amended and restated as of Date 2. The Trust was established by various political subdivisions of the State (the participating employers) to hold assets used to provide health and welfare benefits to their employees, and some former employees, as provided under the Plan. The Trust is managed by a nine-member board of trustees. Each board member is elected by the participating employers.

The board established and administers the Plan, which is set forth in a separate written instrument adopted by the board. The Plan provides health insurance, life insurance, disability insurance, and survivor income benefits.

Each participating employer must be (1) a political subdivision created by and existing under the laws of the State that is also a local government as defined in Statute 1 or (2) a council of governments comprised of State political subdivisions and recognized as a legal entity pursuant to Statute 2. Participants are employees, some former employees, and their spouses, dependents, and beneficiaries.

For each participating employer, the Trust's board and the employer's governing body sign an agreement that binds the employer to the provisions of the trust agreement, defines the participants, identifies those benefits provided by the Plan to participants, and sets forth the employer contributions (and employee contributions, if applicable) to the Trust.

The Trust holds all contributions, together with any appreciation, to be managed and administered in trust pursuant to the terms of the trust agreement. The Trust's assets are applied for the purpose of providing benefits under the Plan, providing related services, and paying the reasonable expenses of administering the Plan and the Trust.

No part of the Trust's assets will inure to a private interest, other than to pay the reasonable expenses of administering the Plan and the Trust. No individual or entity has any rights under the Plan or the Trust except as provided in the Plan and in the trust agreement. Any attempt to assert additional rights will be void.

The Plan and the Trust are always to be operated to comply with all requirements under the IRC.

The Trust may be dissolved by a two-thirds vote of the board. However, upon termination of the Trust, after the payment of outstanding benefits, the Trust's remaining assets will be distributed to the participating employers on a pro-rata basis. In no event will the Trust's assets be distributed or revert to any entity that is not a state, a political subdivision of a state, or an entity the income of which is excludable from its gross income by application of IRC section 115.

## LAW AND ANALYSIS

### Issue 1 – IRC section 115(1)

IRC section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund that is established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under IRC section 115(1) because such investment constitutes an essential governmental function. The ruling explains that the statutory exclusion is intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of an entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or political subdivision of a state. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and that are within the ambit of a sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (e.g., casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under IRC section 115(1) because the organization is performing an essential governmental function. The revenue ruling states that the income of such an organization is excludable from gross income so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefit to the employees of the insurance coverage obtained by the member political subdivisions is deemed incidental to the public benefit.

Through the Trust, political subdivisions of the State are able to provide health and welfare benefits to current, and some former, employees. Providing these health and welfare benefits constitutes the performance of an essential government function within the meaning of IRC section 115(1). See Rev. Rul. 90-74 and Rev. Rul. 77-261.

The Trust's income accrues to political subdivisions of the State. No private interests will participate in, or benefit from, the operation of the Trust other than as providers of goods or services. The benefit to the current and former employees is incidental to the public benefit. See Rev. Rul. 90-74.

In no event, including dissolution, will the Trust's assets be distributed or revert to any entity that is not a state, a political subdivision of a state, or an entity the income of which is excludable from its gross income by application of IRC section 115.

#### Issue 2 – IRC Section 6012(a)(4)

Section 301.7701-1(b) of the Procedure and Administration Regulations ("Regulations") provides that the classification of organizations that are recognized as separate entities is determined under sections 301.7701-2, 301.7701-3, and 301.7701-4 of the

Regulations unless a provision of the IRC provides for special treatment of that organization.

Section 301.7701-4(a) of the Regulations provides that, in general, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

The Trust enables political subdivisions of the State to set aside funds to be used to provide health and welfare benefits to current, and some former, employees as provided for under the Plan. The Trustees are charged with the responsibility for the protection and conservation of the Trust's assets for the benefit of the beneficiaries of the Trust. The beneficiaries of the Trust cannot share in the discharge of the Trustees' responsibility for the protection and conservation of property and, therefore, are not associates in a joint enterprise for the conduct of business for profit. Thus, the Trust is treated as a trust under section 301.7701-4(a) of the Regulations.

IRC section 6012(a)(4) provides that every trust having for the taxable year any taxable income or having gross income of \$600 or more, regardless of the amount of taxable income, shall make returns with respect to income taxes under Subtitle A.

Based solely on the facts and representations submitted by the Trust, we conclude that:

- (1) Because the income of the Trust derives from the exercise of an essential governmental function and accrues to a state or a political subdivision thereof, the Trust's income is excludable from gross income under IRC section 115(1).
- (2) The Trust is classified as a trust under section 301.7701-4(a) of the Regulations. Because the Trust's income is excludable from gross income under IRC section 115(1), the Trust is not required by IRC section 6012(a)(4) to file annual income tax returns.

No opinion is expressed concerning the federal tax consequences under any IRC provision other than the ones specifically cited above. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling concerns only the federal tax treatment of the Trust's income and may not be cited or relied upon by any taxpayer, including the Trust, employers participating in the Trust, and any recipients of benefits paid under the terms of the Trust, as to any matter relating to the taxation of accident or health contributions or benefits.

This ruling is directed only to the taxpayer requesting it. IRC section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Kenneth M. Griffin  
Branch Chief, Exempt Organizations Branch 3  
(Tax Exempt & Government Entities)

cc: